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Global Tax Alert

PE Watch: Latest developments and trends, January 2021

EY Tax News Update: Global Edition

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OECD BEPS Multilateral Instrument

On 18 December 2020, Germany and Pakistan deposited their instrument of ratification of the Multilateral Instrument (MLI) with the Organisation for Economic Co-operation and Development (OECD). Germany confirmed its preliminary positions regarding the PE provisions in which it only chose to apply Article 13(1) Option A (the list of activities, or the combination thereof, is restricted to activities of a preparatory or auxiliary character). Germany also removed 22 tax treaties from its list of Covered Tax Agreements (CTAs) and added the tax treaty with Greece. Pakistan changed its preliminary positions regarding the PE provisions by removing the reservations on all PE articles of the MLI and hence would like to apply all MLI PE provisions to its CTAs. Further, Pakistan added three tax treaties (Brunei Darussalam, Bulgaria and Hong Kong) to its list of CTAs. The MLI will enter into force for these jurisdictions on 1 April 2021.

On the same date, Switzerland notified that it has completed its internal procedures for the entry into effect of the MLI provisions with respect to the CTAs with Lithuania and Czech Republic, which is required when a signatory has made the reservation in Article 35(7)(b) of the MLI. With respect to the PE provisions of the MLI, Switzerland reserved its right not to apply all of the PE provisions. The MLI will have effect on the notified CTAs with respect to taxes withheld at source on 1 January 2022 and with respect to all other taxes on 17 July 2021.

Building a better working world

On 21 December 2020, Barbados also deposited its instrument of ratification of the MLI with the OECD. Barbados confirmed its preliminary positions regarding the PE provisions in which it reserves the right to not apply any of the PE provisions in the MLI. Furthermore, Barbados updated its list of CTAs to remove the tax treaties with the Caribbean Community (CARICOM) and Ghana. The MLI will also enter into force for Barbados on 1 April 2021.

Case law PE developments

France

On 11 December 2020, the French Administrative Supreme Court (Supreme Court) ruled in case Nº 420174 that an Irish resident entity performing digital marketing activities has a PE in France, overturning the decision from a lower court. In the case at hand, a French subsidiary of the Irish entity habitually had authority to decide on client transactions that were automatically confirmed by the Irish entity. According to the French tax authorities, the French employees acted as employees of the Irish entity and clients did not distinguish between the employees from the French or Irish entity. Hence, although the French entity did not formally have the authority to sign contracts on behalf of the Irish entity, the decision to conclude a contract with a client, as well as all related tasks, were actually made and performed by the employees of the French entity.

In addition, as consideration for the services, the French entity was remunerated on a cost plus 8% basis.

According to the French tax authorities, the Irish entity had a fixed place of business within the meaning of the Irish-French Double Tax Treaty (the DTT) in the premises of its French subsidiary.

The Supreme Court ruled that the French entity is a dependent agent PE (DAPE) of the Irish entity since the French entity habitually makes all preparations and decisions to enter into contracts with clients on behalf of the Irish entity. Also, the Supreme Court concluded the Irish entity has a fixed establishment for value added tax (VAT) purposes in France.

The wording of the DAPE provisions in the tax treaty between Ireland and France which dates back to 1968 is in fact similar to the one in the OECD Model Tax Convention (OECD MTC) 2010. Therefore, the outcome of this case is a very important development in the interpretation and application of tax treaties that do not follow the language from the MLI or the OECD MTC 2017.

See EY Global Tax Alert, *French Administrative Supreme Court expands its definition of a dependent agent constitutive of a permanent establishment*, dated 18 December 2020.

India

On 9 December 2020, the Indian Income Tax Appellate Tribunal (ITAT) issued its decision No. 1500/DEL/2014 on whether a Chinese company could create a PE for supplying and installing telecommunication equipment in India. In this case, the Chinese company had a subsidiary in India involved in the provision of integration, installation and commissioning services in relation to equipment supplied from outside India by the Chinese company. Further, the Chinese company sent its technical experts on site in order to supervise the installation and commissioning process undertaken by the Indian subsidiary.

After examining the documents during survey proceedings, the tax authorities concluded that the employees of the Chinese company and its subsidiary in India had worked jointly for negotiation and conclusion of contracts with the customers in India. For that purpose, the employees of the Chinese company had used the office premises of its subsidiary in India. Therefore, the Indian Tax Authorities assessed the existence of a fixed place of business and a DAPE. Further, the tax authorities also found that the Chinese company performed activities in connection with various installation projects for the telecommunication equipment and that it also rendered services in India other than services in the nature of technical services. Hence, the tax authorities also assessed the existence of an installation PE and a service PE for the Chinese company.

With respect to the fixed place of business in India, the ITAT upheld the tax authorities' position by noting that the employees of the Chinese company regularly used the office premises in India. In relation to the DAPE, the ITAT also upheld the tax authorities' position by noting that the employees of the Indian subsidiary were involved in deal negotiation on behalf of the Chinese company and the joint bidding team included employees from the Chinese company as well as the Indian subsidiary. The Indian subsidiary constituted the DAPE of the Chinese company since it was economically dependent on the Chinese company and its employees were negotiating contracts on behalf of the Chinese company in India. For the installation PE, although the contracts were signed between the subsidiary in India and Indian customers, the ITAT concluded that the Indian subsidiary was not technically equipped to do such

installation on its own and the project required foreign experts in the technology behind the equipment which were present in India for more than 183 days in order to supervise the installation process. Lastly, the ITAT also concluded that the Chinese company has a Service PE in India based on the overall facts and agreements.

Additionally, without a detailed explanation, the ITAT concluded that the Chinese company had a PE in India and attributed the income from the supply of the equipment as business income arising from the PE in India.

Domestic law PE developments

Finland

On 31 December 2020, Finland published Law 1188/2020 to expand the concept of tax residency to also include foreign entities whose place of effective management is in Finland. The place of effective management is the place where the entity's highest-level decisions concerning daily management are made. If a foreign entity has a PE in Finland after the law enters into effect, and the activities carried out by the PE meet the conditions for a place of effective management in Finland, then the foreign entity will be considered as a tax resident in Finland and will have the same business ID as the PE.

Further, losses by a foreign entity prior to becoming a Finnish tax resident, will not be deductible in Finland, unless the losses were attributable to a Finnish PE prior to obtaining the tax residency in Finland. The Law entered into effect on 1 January 2021 and the new provisions apply for the first time in the assessment to be concluded for tax year 2021, with certain exceptions.

If a foreign entity with a Finnish PE becomes a Finnish tax resident under the new legislation and under the provisions of the relevant tax treaty, the Finnish PE will cease to exist and the company will be considered as a foreign entity with tax residency in Finland.

Portugal

On 31 December 2020, Portugal published Law no. 75-B/2020 which approves the 2021 State Budget Bill submitted to the Parliament in October 2020. With respect to PEs, the Law includes all the proposed changes in the Bill from October 2020. The Law is effective from 1 January 2021.

For more details, see EY Global Tax Alert, *PE Watch: Latest trends and developments November 2020*, dated 12 November 2020.

Ukraine

Recently, the State Tax Service of Ukraine (STS) clarified amendments for tax registration of a PE in Ukraine introduced by Law No. 786-IX dated 14 July 2020. Pursuant to this law an obligation to register a PE in Ukraine is placed upon a nonresident legal entity whose activities in Ukraine give rise to a PE. A nonresident legal entity which conducts activities in Ukraine through a PE but fails to comply with the registration requirement is considered to commit tax evasion.

Before the change, there was a similar rule in the Ukrainian Tax Code, but it placed an obligation to register and responsibility for non-compliance on the PE. This created ambiguity, because a PE is not a person under the Ukrainian civil and tax law, and for that reason it was practically difficult for the tax authorities to enforce the rule. Now the law and the tax authorities expressly have clarified that it is a nonresident legal entity who bears the responsibility. Another Law No. 466-IX from 16 January 2020 also introduced a procedure for the tax authorities to bring the nonresident legal entity to responsibility and force it to register the PE.

These changes are effective from 1 January 2021.

United States

On 11 December 2020, final regulations (TD 9921) were published in the Federal Register that include rules for determining the source of income from sales of inventory produced within the United States (US) and sold outside the US or vice versa. The final regulations provide that sales of inventory produced outside the US and sold through an office or other fixed place of business in the US must be allocated in part to the US, unless the inventory is sold for use, disposition, or consumption outside the US and a foreign office of the nonresident materially participates in the sale. Also, the final regulations provide two methods to properly allocate the gross income attributable to a nonresident's office or other fixed place of business in the US. Under the default 50/50 method, 50% of a nonresident's gross income would be properly allocable to the nonresident's office or other fixed place of business in the US and the remaining 50% of gross income would be allocated or apportioned based on the location of the nonresident's production activities. In lieu of the 50/50 method, the final regulations allow nonresidents

to elect a books and records method (provided that certain requirements are met) that would reflect their gross income from both sales and production activities.

In general, the final regulations apply to taxable years ending on or after 23 December 2019. However, a taxpayer and all related parties (within the meaning of Section 267 or 707) may apply the final regulations in their entirety for any taxable year beginning after 31 December 2017, and ending before 23 December 2019, so long as the taxpayer and all related parties apply the final regulations in their entirety for all taxable years thereafter.

See EY Global Tax Alert, *US: Final regulations add clarifications and revisions to source-of-income rules*, dated 9 October 2020.

PE developments in response to COVID-19

Germany

On 28 December 2020, the German Ministry of Finance updated its Frequently Asked Questions (FAQs) to clarify more questions on tax relief measures intended to aid businesses impacted by the pandemic and extend the period in which the measures are applicable. These FAQs replace the ones published on 6 May 2020 and continue to only cover construction PE situations. Hence, with respect to Pes, the only difference is that the guidance will now be applicable until 31 March 2021.

For additional information with respect to this Alert, please contact the following:

Ernst & Young Belastingadviseurs LLP, Rotterdam
- Ronald van den Brekel ronald.van.den.brekel@nl.ey.com

Ernst & Young Belastingadviseurs LLP, Amsterdam
- David Corredor-Velásquez david.corredor.velasquez@nl.ey.com
- Roberto Aviles Gutierrez roberto.aviles.gutierrez@nl.ey.com
- Konstantina Tsilimigka konstantina.tsilimigka@nl.ey.com

Ernst & Young Solutions LLP, Singapore
- Chester Wee chester.wee@sg.ey.com

Ernst & Young LLP (United States), Global Tax Desk Network, New York
- Jose A. (Jano) Bustos joseantonio.bustos@ey.com

Ernst & Young LLP (United States), Washington, D.C.
- Arlene S. Fitzpatrick arlene.fitzpatrick@ey.com

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